

TOWN OF HARPSWELL, MAINE
Management's Discussion and Analysis
December 31, 2005

As management of the Town of Harpswell, Maine, we present this narrative to provide you with an overview and analysis of our annual financial statements for the year ended December 31, 2005. This information, in conjunction with the notes to the financial statements, can be considered when reading the Town's financial statements.

Certain 2004 amounts have been reclassified to conform to the 2005 presentation.

Financial Highlights

- ❖ Total assets of the Town of Harpswell exceed its liabilities by \$7,225,220. Total assets include the costs of the 2005 reconstruction of six Town roads, (\$560,658), but exclude the remainder of the Town's infrastructure assets. This infrastructure, primarily roads, will be included in future years when required by GASB #34.
- ❖ The Statement of Activities shows an increase in net assets of \$1,035,122 for the fiscal year. In addition to the capital road project referred to above, the Town invested \$133,750 in the restoration of the Old Town Meetinghouse, acquired a piece of land at the end of Holbrook Street for \$30,724 and was deeded the land and buildings outside the Mitchell Field gate which were valued at \$282,700.
- ❖ During 2005, the Town repaid \$415,833 of the principal of its long-term debt.
- ❖ The ending fund balance for all governmental funds is \$3,552,555.
- ❖ The ending fund balance for the general fund is \$3,493,511, an increase of \$286,739 over the previous year. Of this balance, \$538,714 is designated for on-going projects. This leaves an undesignated balance of \$2,954,797- which provides an adequate surplus. Additionally, the Town has a fund designated for capital projects, and a fund for its special revenue activities. During 2005, the fund designated for capital projects decreased from \$630,878 to \$4,476 as the capital road project and restoration of the Old Town Meetinghouse were substantially completed.

Overview of Financial Statements

The Town of Harpswell's basic financial statements are comprised of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains other supplemental information in addition to the basic financial statements.

Government-wide Financial Statements

The *government-wide financial statements* provide a broad overview of the Town of Harpswell's finances, in a manner similar to private-sector business. Financial information is presented in two statements – *statement of net assets* and *statement of activities*.

The *statement of net assets* presents information about the Town's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Town is improving or deteriorating.

The *statement of activities* presents information about how the Town's net assets have changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the Town of Harpswell that are principally supported by taxes and intergovernmental revenues. The governmental activities of the Town of Harpswell include general government, public works (roads, solid waste disposal), protection and safety (law enforcement, fire protection), health and welfare, culture and recreation, debt service and capital planning expenses.

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Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Town of Harpswell, like other state and local governments, uses fund accounting to insure and demonstrate compliance with finance-related legal requirements.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Town's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The Town of Harpswell maintains five individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund. Data from the four governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of *combining statements* elsewhere in the report.

The Town of Harpswell adopts an annual appropriated budget for its general fund. A budgetary comparison statement has been provided for the general fund to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found on pages 15-16 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 19-30 of this report.

Other information. The combining statements referred to earlier in connection with non-major governmental funds are presented immediately following the notes to the financial statements. Combining and individual statements and schedules can be found on pages 33-43 of this report.

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Statement of Net Assets Information

The following information is a condensed version of the Statement of Net Assets.

		Governmental Activities	
		<u>2005</u>	<u>2004</u>
Assets:			
Current & other assets		\$3,740,607	\$ 4,230,842
Capital assets		5,884,362	4,953,197
Total Assets		<u>9,624,969</u>	<u>9,184,039</u>
Liabilities:			
Long-term debt outstanding		(2,326,667)	(2,746,680)
Other liabilities		(73,082)	(247,261)
Total Liabilities		<u>(2,399,749)</u>	<u>(2,994,941)</u>
Net Assets:			
Invested in capital assets, net of debt		3,909,495	2,187,918
Restricted		26,767	702,873
Unrestricted		3,288,958	3,299,307
Total Net Assets		<u>\$7,225,220</u>	<u>\$ 6,190,098</u>

The Town's Total Net Assets increased by \$1,035,122 during 2005. Of this increase, approximately \$441,000 is the result of increases in assets and approximately \$595,000 is the result of decreases in liabilities.

At the end of 2004, the Town's cash balances included amounts to be used for a major road project, restoration of the Old Town Meetinghouse and a Town-wide revaluation. The decrease in "Current and other assets" resulting from the expenditure of these amounts during 2005 was in part offset by an increase in Taxes Receivable of \$237,170. For 2005, taxpayers could elect to pay their real estate taxes in 2 payments with the second payment due on December 15, 2005. In certain cases, it appears that taxpayers who took this option and would have otherwise paid their taxes in full in October forgot that a second payment was due.

Capital Assets increased during 2005 as a result of the substantial completion of the capital road project and the Old Town Meetinghouse restoration. Additionally, the Town was deeded the ownership of certain land and buildings at Mitchell Field and acquired a parcel of land at the end of Holbrook Street. Further, the Recycling Center replaced its backhoe.

Long-term Debt obligations decreased during 2005 as a result of scheduled repayments and the absence of new borrowings. Other liabilities at the end of 2004 were unusually high as a result of obligations under the Town's revaluation contract and the purchase of winter sand and salt during the last few days of the year. These commitments did not recur in 2005.

54% of the Town's Net Assets at December 31, 2005 is represented by its capital assets less any debt outstanding that was used to acquire those assets. Although the Town's investment in capital assets is reported net of related debt, the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

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A small portion of the 2005 Net Assets is Restricted for Capital Projects and grants. The decline during 2005 reflects the substantial completion in 2005 of certain capital projects.

Unrestricted Net Assets includes amounts designated to be expended for certain purposes in subsequent years.

Statement of Activities Information

The following information is a condensed version of the Statement of Activities.

Town of Harpswell
Changes in Net Assets

		Governmental Activities	
		<u>2005</u>	<u>2004</u>
Revenues:			
Program Revenues			
Charges for services	\$227,394	\$	204,421
Operating grants & contributions	134,374		239,472
General Revenues			
Property and excise taxes	10,625,102		9,838,671
Subsidies, grants & entitlements	266,974		284,196
Interest earned	49,512		28,138
Other	466,527		238,065
Total revenues	\$11,769,883	\$	10,832,963
		Governmental Activities	
		<u>2005</u>	<u>2004</u>
Expenses:			
General government	1,114,356		961,791
Public works	834,654		915,356
Protection and safety	629,084		870,699
Health and welfare	28,783		24,592
Culture and recreation	238,216		224,426
Education	6,714,259		6,239,379
County taxes	739,377		721,306
Overlay/abatements	67,035		108,077
Interest on long-term debt	131,082		103,928
Capital and special projects	237,915		418,499
Total expenses	\$10,734,761	\$	10,588,053
Increase (decrease) in net assets	\$1,035,122	\$	244,910

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Governmental Activities

Governmental activities increased the Town's net assets by \$1,035,122. Program revenues were lower in 2005 than in 2004 as increases in the Recycling Center and Transfer Station revenues were offset by reductions in grants and other contributions. 2005 was the first full year in which increases in Transfer Station fees were in place. Also during 2005, the State of Maine decreased its support of programs in the areas of small community grants and grants for overboard discharge. Property and excise tax revenue increased as the property tax base expanded. Other revenues include the donation in 2005 of \$282,700 in land and buildings at Mitchell Field.

To aid in the understanding of the Statement of Activities, some additional explanation is provided. Please note that the format differs from that of the Statement of Revenues, Expenditures, and Changes in Fund Balance. Expenses for each activity are listed in the left-most column with revenues generated by that particular activity reported to the right. Subtracting one from the other results in a Net (Expense)/Revenue. This format provides information about the relative financial burden on the Town's taxpayers of each activity. It should be noted, however, that while these revenues may be generated by specific activities, the Town does not have dedicated revenue sources. Accordingly, revenues from specific activities are deposited to the Town's general fund, as are all tax payments received. From this fund, the Town makes all its expenditures.

Examples of activities which produce some level of revenue are:

<i>Public works</i>	Transfer Station fees and recycling revenues Local Road Assistance
<i>Health and welfare</i>	General Assistance state reimbursement
<i>Cultural and recreational</i>	Fees for recreation programs
<i>Capital and special projects</i>	Grants for restricted projects

All other governmental revenues are reported as general revenues. It is important to note that all taxes are classified as general revenue, even if restricted for a specific purpose.

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Net Cost of Governmental Activities

The following information is a breakdown of each of the Town's major functional activities.

Town of Harpswell
Net Cost of Governmental Activities

Function / Program	Total Cost of Services		Net Cost of Services	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
General government	\$1,114,356	1,059,939	\$1,114,356	\$ 1,059,939
Public works	834,654	915,356	603,364	709,768
Protection and safety	629,084	650,282	629,084	650,282
Health and welfare	28,783	24,592	21,191	21,016
Culture and recreation	238,216	224,426	196,812	180,293
Education	6,714,259	6,239,379	6,714,259	6,239,379
County taxes	739,377	721,306	739,377	721,306
Overlay/abatelements	67,035	108,077	67,035	108,077
Interest on long-term debt	131,082	103,928	131,082	103,928
Capital and special projects	237,915	540,768	156,433	350,172
Total governmental activities	<u>\$10,734,761</u>	<u>\$ 10,588,053</u>	<u>\$10,372,993</u>	<u>\$10,144,160</u>

Total Cost of Services and Net Cost of Services increased from 2004 to 2005 by 1.4% and 2.2%, respectively. The increased assessments made by MSAD #75 and by Cumberland County reflect the increase in the Town's valuation. Interest on long-term debt increased as a result of amounts borrowed in 2004.

FINANCIAL ANALYSIS OF THE TOWN'S FUNDS

As of December 31, 2005, the Town's governmental funds balance totaled \$3,552,555.

As noted earlier, the Town uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The financial performance of the Town as a whole is reflected in its governmental funds.

Governmental funds: The focus of the Town's governmental funds is to provide information on near-term inflows, outflows, and balances available for spending. Governmental funds report the differences between their assets and liabilities as fund balances. Reserved amounts reflect that which is not available to be spent while undesignated amounts reflect amounts that are.

GENERAL FUND BUDGETARY HIGHLIGHTS

The Town's general fund balance increased 8.9% from \$3,206,772 to \$3,493,511. The increase of \$286,739 was attributable to (1) revenues exceeding expenditures; (2) unexpended appropriations lapsing; and (3) unused overlay funds.

Revenues. As a result of the 2005 Town Meeting, more non-property tax revenue was used in 2005 than in 2004 to offset the tax commitment. Of the \$1,500,000 used in 2005, \$1,041,593 was derived from the collection of excise tax (the single largest source of non-property tax revenue to the Town); \$185,990 from Recycling Center and disposal fees; and \$120,985 from the collection of fees and issuance of licenses. Three areas where actual revenues more than exceeded budgeted projections were in the collection of supplemental taxes, as a result of tree growth penalties and collection of prior year taxes, (\$98,317 in excess); interest earnings on cash investments (\$27,112 in

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excess); and fines and violations (\$18,381 in excess). The Town received less municipal revenue sharing from the state in 2005 (\$202,629) than in 2004 (\$212,347), which was expected—the trend is likely to continue in 2006. The Town also received less tree growth reimbursement from the state in 2005 than 2004 which was not expected; apparently the state miscalculated and plans to send additional reimbursement to the Town.

Unexpended appropriations. Two areas of the 2005 appropriated budget where there were noticeable lapses to general fund were in (1) operations of the recycling center and transfer station (\$47,826) and (2) assessing (\$20,562). With respect to recycling center and transfer station operations, the new collective bargaining agreement held wages to a reasonable increase and overall there was a leveling off of annual tonnage received and processed compared to anticipated volumes. In the assessing department, the Town was prepared to fund two full-time assessors, but ended up funding one full-time employee and contracting for other part-time services. Many assessing functions in 2005 were performed by Vision Appraisal which was hired to perform and complete a town-wide revaluation.

Overlay. In 2005, the Board of Selectmen, pursuant to statutory authority, set the overlay amount at \$225,413 [The overlay was \$82,752 in 2004]. During a revaluation year, it is advisable to select a higher than normal overlay in the event that there are more than the customary number of abatements. In 2005, \$67,035 was used for abatement purposes with the remaining \$158,378 lapsing to the general fund.

Contingency. The Town maintains a contingency reserve in the amount of \$80,000 to cover unanticipated budget shortfalls. In 2005, Selectmen approved the use of contingency funding in the amount of \$27,739 to cover overages in legal (\$16,108); membership dues (\$13); operations and maintenance (\$4,485); Old Town Office improvements (\$3,293); health and welfare (\$2,223); and debt service (\$1,617).

Harpswell maintains a healthy general fund balance that is used to fund first quarter expenditures until such time as a tax anticipation note is needed to fund expenditures up to the time when property tax revenue is collected.

The Town Meeting, which is held in March of each year, votes on the budget as recommended by the Selectmen for the upcoming year.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2005, the Town had \$5,884,362 net investment in capital assets (excluding infrastructure invested in before 2005), and outstanding debt of \$2,326,667. \$351,800 of the outstanding debt was borrowed to finance Town-wide revaluations in 1997 and 2004, and to contribute to the Harpswell Heritage Land Trust. The remainder of the debt was borrowed to acquire, build or renovate land, buildings and equipment at the Town offices and the Town's solid waste facility.

Town of Harpswell
Capital Assets, net of depreciation

	Capital Assets		Accumulated Depreciation		Capital Assets, net of depreciation	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Land	\$ 1,980,461	\$ 1,893,054	\$ -	\$ -	\$ 1,980,461	\$ 1,893,054
Construction in progress	560,658	-	-	-	560,658	-
Buildings and building improvements	4,023,632	3,652,533	(993,176)	(862,786)	3,030,456	2,789,747
Equipment and furniture	618,249	576,872	(305,462)	(306,476)	312,787	270,396
Total capital assets	\$ 7,183,000	\$ 6,122,459	\$ 1,298,638	\$ 1,169,262	\$ 5,884,362	\$ 4,953,197

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During 2005, the Town's capital assets were increased through the receipt from the Federal government of certain land and buildings outside Mitchell Field (approximately \$282,700), as well as improvements to the Old Town Meetinghouse (\$133,750), purchase of a parcel of land at the end of Holbrook Street (\$30,724) and the replacement of the backhoe at the recycling center (approximately \$40,000).

ECONOMIC FACTORS AND NEXT YEAR' S BUDGETS AND RATES

The Town of Harpswell is predominantly a residential and seasonal community. The Town does not have any significant commercial or industrial sector to support the cost of municipal government. The presence of a large number of seasonal homes, most of which are owned by nonresidents, provides a significant source of property tax revenue for the Town. This benefit, however, is counterbalanced by county taxes and high assessments by MSAD # 75, resulting from the high total property valuation of the Town.

In 2005, the Naval Air station, which is situated in the adjacent community of Brunswick, was slated for military closure in approximately four years. It remains unclear what economic impact this will have on Harpswell, particularly with respect to the value of real estate in the Town. Market prices for waterfront and water view real estate, which drive the escalating Town valuation, may continue to increase despite the uncertainty of the future of Brunswick Naval Air Station.

The Selectmen of the Town were in discussions with SAD # 75 representatives in 2005 about the local cost sharing formula. With Harpswell's rapidly increasing property valuation and the new state Essential Programs and Services funding model, the situation has only worsened with respect to Harpswell paying a disproportionate share of the school budget. Selectmen efforts were not successful. As a result, a citizen-initiated petition was approved by voters to begin the process of withdrawing from the District. It is not clear how long the withdrawal process might take or if it will succeed. Many financial details need to be addressed before the voters of Harpswell can make a decision on the withdrawal agreement. Some estimates have shown that Harpswell may save money by running its own elementary schools and paying tuition for its middle and high school age students to attend schools in SAD #75 or another district. There is currently legislation being proposed at the state level which may provide special education funding to Harpswell and may mitigate its desire to withdraw from SAD # 75.

LD 1 legislation was passed in 2005 to create a cap on the amount of local property tax that can be raised each year. In 2005 it applied only to municipalities with July-June fiscal years; it will, however, apply to Harpswell's 2006 budget. The Town Meeting may vote to exceed or increase the cap if it so desires. It is anticipated that Harpswell will stay under the LD 1 imposed cap in 2006.

Currently, the state legislature is developing legislation to give tax breaks to landowners who use their property for commercial fishing purposes. The language is currently being developed, and it remains unclear if this option will be available to taxpayers in 2006, and if so, how many taxpayers may take advantage of this incentive, and what impact it may have on the other taxpayers in the Town.

Budget development is always predicated on a concern that not all the residents of the Town have incomes that keep pace with the rate of property valuation. The 2006 budget proposes modest increases in most departmental expenses; however certain market forces are driving more than modest increases in areas of the budget such as employee benefits for health insurance coverage and in facilities operations for fuel and maintenance cost increases. The 2006 budget proposes to spend more funds on road maintenance since there has been deferral of maintenance over the past couple of years. Also, the 2006 budget calls for borrowing to fund another capital road project so that the cost of the capital project and asset can be spread over a period of years. Utilizing undesignated fund balance will obviate the need to exceed or increase the LD 1 imposed limit on the amount of property tax raised in 2006.

CONTACTING THE TOWN' S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the Town' s finances and to show the Town' s accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Selectmen' s Office at P.O. Box 39, 263 Mountain Road, Harpswell, Maine 04079-0039 or by phone at (207) 833-5771.